

Internal Revenue Service

Number: **200937002**

Release Date: 9/11/2009

Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01 – PLR-102459-09

Date:

June 11, 2009

X =

State =

Date 1 =

Date 2 =

a =

x =

y =

Properties =

PLR-102459-09

Dear _____ :

This responds to a letter dated December 18, 2008, submitted on behalf of X by X's authorized representative, requesting a ruling that X's rental income from Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

Facts

The information submitted states that X is incorporated in State. The shareholders of X elected to treat X as an S corporation on Date 1. At the time of the S election, X had accumulated earnings and profits from its C corporation operations, which still exist today.

X represents that X owns Properties. Properties are residential and commercial properties that X leases to third parties. Approximately a employees of X are involved in the day-to-day operations of Properties. X represents that, through its employees and independent contractors, it provides various services to the tenants of Properties. These services include, among other things, moving out vacating tenants, preparing vacancies for re-rental, advertising for new tenants, performing market surveys, processing prospective tenant applications, moving in new tenants, handling all communications with tenants during tenancy, and hiring necessary vendors to maintain buildings and grounds. For the fiscal year ending Date 2, X received \$x in gross rental income and X paid or incurred \$y in expenses (other than depreciation) with respect to Properties.

Law and Analysis

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to above.

Section 1362(d)(3)(C)(i) provides that except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(2) of the Income Tax Regulations provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Conclusion

Based solely on the facts and the representations submitted we conclude that the rental income that X derives from Properties is not passive investment income as described in § 1362(d)(3)(C)(i).

Except as specifically set forth above, we express no opinion as to the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, we express no opinion on whether X is a small business corporation eligible to make an S election. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of section § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

David R. Haglund

David R. Haglund
Acting Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: